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Carl Hansen
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By email: submissions@ea.govt.nz

Dear Carl

Submission on Transmission Pricing Methodology: Connection charges Working paper

Genesis Energy Limited welcomes the opportunity to provide a submission to the Electricity Authority ("the Authority") on its working paper "Transmission Pricing Methodology: Connection Charges" dated 13 May 2014.

Genesis Energy does not see a problem to justify the changes proposed. Firstly, there are already significant checks in place to ensure that connection assets are characterised correctly. Secondly, the options proposed do not take into account the benefits inherent in the current approach. We encourage the Authority to prioritise its efforts on the components of the TPM that have more potential to produce material benefits to consumers.

There are sufficient checks in place

Current level of scrutiny on Transpower's investments

There are currently several avenues to ensure scrutiny of Transpower's investments. Transpower's capital expenditure ("capex") must be approved by the Commerce Commission ("the Commission"). The Commission reviews all

major transmission projects and Transpower's overall capex allocations (for minor projects).[1]

In order to comply with the Electricity Industry Participation Code 2010, each year Transpower consults with all connected parties on the price and quality of planned work and the service levels to be included in transmission agreements for each site.[2] Transpower reports annually to each connection customer on availability and reliability performance (against service levels) for each applicable site. Transpower also publishes annually a Quality Performance Report which includes point of service performance. Finally, Transpower's Annual Planning Report incorporates its assessment of bus security issues and proposed or potential solutions. Together, this information can be used to inform and assess Transpower's subsequent investment decisions.

Connection customers also have more informal channels to monitor quality and service levels via their relationships with Transpower's customer solutions manager. In practice, customer expertise is more likely to limit levels of scrutiny than customer incentives or opportunities for engagement.

Incentives to socialise connection costs as interconnection assets

The working paper raises concerns regarding incentives to shift connection assets to interconnection assets, as a result of either inefficient asset configuration, or staged commissioning of assets. Genesis Energy does not consider these concerns are commonly observed in practice. In particular:

- **Inefficient asset configuration is unlikely in practice.** Theoretically, connection customers have an incentive to shift the categorisation of connection assets to interconnection assets so as to socialise the costs. However, there are checks in place to address this concern (as discussed above). Furthermore, the current process enables Transpower to review the categorisation of assets.

  Practical evidence suggests Transpower reviews this categorisation and takes action when it considers an existing configuration or categorisation is not appropriate. For example, Genesis Energy's Tokaanu connection

[1] As set out under Sections 54R and 54S of the Commerce Act 1986 and consistent with the Commerce Commission's input methodologies (see: http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/transpower-input-methodologies/). Transpower also report on this capital expenditure in its Annual Regulatory Report, see: https://www.transpower.co.nz/sites/default/files/publications/resources/annual-regulatory-report-2012-13_1.pdf

[2] See: https://www.ea.govt.nz/operations/transmission/transmission-agreements/

assets were re-categorised from interconnection to connection assets in 2008. We are also aware of a separate example where a connection was proposed in a loop configuration by a connection customer but Transpower instead undertook an alternative, cheaper solution that involved clearly designated connection assets.

If a connection customer wanted a greater level of security or quality of supply, it may be willing to enter a Customer Investment Contract rather than share the cost of an asset (if this means it would have less say in the asset's operation and maintenance). However, in practice, Genesis Energy as a connection customer places significant weight on the standards Transpower must adhere to and on Transpower's asset management framework. Genesis Energy also relies to some degree on Transpower given its relative experience in this area and the scrutiny it faces.

- **Charges should reflect the rationale for the investment rather than the stage of commissioning,** Genesis Energy considers that where an interconnection project is configured for a period as a connection asset, the charging for the asset should generally reflect the underlying rationale for the investment when approved by the Commission.

Incentives for Transpower to grow its RAB

The current regulatory regime is designed to address Transpower's incentive to grow its RAB, and generators have incentives to engage to minimise costs when they consider new generation projects.

We agree that Transpower has an incentive to grow its capex. However, the regulatory settings applying to Transpower are designed to limit this by requiring capex levels (and major projects themselves) to be approved by the Commission. Furthermore, the regulatory regime incentivises Transpower to manage its capex by sharing any savings with consumers (as acknowledged by the Authority on page 16 of the working paper).

Connection customers also have an incentive to minimise their cost to connect. This should act as a constraint on Transpower. Genesis Energy gives this particular consideration when potential generation projects are being reviewed to ensure the proposed solution incurs only necessary costs. At this stage it is easiest for customers to query options and investigate alternatives. For example, they may obtain an independent engineer's assessment at this stage.

Transpower is an attractive counter-party due to expertise

While it is open for other parties to bid for and undertake connection work, Transpower's experience and scale make them an attractive counterparty for projects where it is preferable to connect directly to the grid. For example, Genesis Energy has historically contracted with either Transpower or the local distributor (in the case of embedded generation). From our perspective this minimizes our risk as it involves personnel with the most expertise.

As noted above, connection customers still have an incentive to minimise the connection costs and will try to identify the cheapest option that provides connection while still meeting service standards. However, connection customers may not consider developing or contracting for the development of connection assets to be their core business, and may prefer to use Transpower given its experience. Connection customers would also not wish to take on the liability for such assets but allocate these risks to others they feel are better able to manage them.

There is value to customers in flat charges

Genesis Energy values the current flat charges and considers that pursuing a Depreciated Replacement Cost ("DRC") approach is unlikely to bring about efficiencies and will introduce unnecessary volatility.

We consider connection of assets to the transmission grid as an infrastructure service not unlike phone lines, electricity distribution, or water supply. What matters is the ability to connect – as long as agreed service levels are met.

We are skeptical that a change from flat charges to a DRC approach will provide benefits to consumers or Genesis Energy. In particular, we note the following issues:

- A DRC approach would introduce lumpiness and unpredictability in charges;
- Customers are unlikely to bring significant additional scrutiny to the existing categorization or classification issue;
- The practical barriers to other parties developing connection assets are minor and result from a valued feature of Average Replacement Cost (ARC), namely stable charges; and
- Efficiencies are unlikely, as the actions of customers and Transpower are not likely to change.

Cost-based allocation of operating expenses would be more transparent but may not increase efficiency

As a general proposition, Genesis Energy supports cost-based allocation. Charging based on actual operating and maintenance costs is more transparent and equitable (as costs relate more directly to the asset of interest). However, we do not consider cost-based allocation will necessarily increase efficiency in this case.

Transpower's regulatory settings should ensure that replacement versus maintenance tradeoffs are considered. For a fulsome comparison, the Authority may consider coupling cost-based charges with DRC-based charges. However, as discussed in the preceding section, there are a number of unresolved concerns with DRC-based charges that make this an unattractive option.

A cost-based approach could instead be applied to operating costs alone (without a change to DRC-based charges). But even this, in our view, is not necessarily optimal and will not necessarily lead to greater efficiency in practice. This is because customers' asset demands are driven by other factors, and the operating expenses of connection assets are unlikely to be a material consideration.

The size of the issue is insufficient to justify significant effort

Overall, we consider the proposed changes are unlikely to produce efficiencies and will introduce unnecessary volatility given the size of the issue.

Connection charges represent around 15 percent of transmission charges and less than 1.5 percent of retail electricity prices. Connection charges represent a small component of the transmission revenues Transpower recovers relative to interconnection charges.[3] Across all connection assets, total connection charges are roughly equivalent to HVDC charges, representing around 15 percent of transmission charges.

Given this, Genesis Energy encourages the Authority to prioritise its effort on the components of the TPM that have the potential to produce material benefits for the parties involved, and ultimately consumers.

In addition to the points outlined in our submission above, answers to the specific questions in the consultation paper are outlined in Appendix A.

If you would like to discuss any of these matters further, please contact me on 04 495 3340.

Yours sincerely

Jeremy Stevenson-Wright
Regulatory Affairs Manager

[3] See: https://www.transpower.co.nz/sites/default/files/uncontrolled_docs/year-specific-data-2013-14.pdf

Appendix A: Responses to Consultation Questions

QUESTION	COMMENT
Q1: Does the disparity between connection and interconnection charges create inefficiencies or any other perceived problems within the transmission network? What are potential solutions?	See cover letter.
Q2: Is there an efficiency rationale for connection charges to be subject to flattened service-type charges or would it be more efficient for connection charges to reduce as connection assets age, and service levels decrease?	See cover letter.
Q3: Is there currently sufficient connection customer scrutiny over Transpower's investments that are required to meet the GRS?	See cover letter.
Q4: Is Transpower's investment in connection pool assets efficient?	Genesis Energy does not consider that the changes proposed are likely to increase efficiency.
Q5: Would moving to DRC-based costs improve customer scrutiny over Transpower's connection pool assets or would it cause too much customer scrutiny and result in customer opposition to investments Transpower undertakes to meet the GRS?	See cover letter.
Q6: Do ARC-based charges reduce the ability of other parties to compete with Transpower for the provision of assets required for the GRS?	Not to a significant extent, and only as a result of an efficiency gain. If the efficiency gain was not shared with customers, Transpower would still have a competitive advantage as set out in our cover letter.

QUESTION	COMMENT
Q7: Are ARC-based charges necessary in order for Transpower to promote efficient fleet decisions (assuming fleet-based management is efficient)?	No comment. We suggest Transpower may be able to respond.
Q8: To what extent is it efficient for asset replacements or upgrade decisions to be based on the condition of an individual asset compared with the condition of the overall fleet?	No comment. We suggest Transpower may be able to respond.
Q9: Would moving to DRC-based charges reduce the probability and impact of asset stranding, thus reducing the amount of cost socialisation within the connection pool?	In practice this seems unlikely as Transpower forms a view on future scenarios based on the best information it is able to obtain.
Q10: Are current connection charge arrangements appropriate? Are there net benefits in Transpower providing a flattened charge for connection pool assets in place of customers facing an actual-cost based methodology and selecting their own payment profile using the finance markets?	See cover letter.
Q11: How viable is charging operating expenses according to actual costs? Are there other ways in which existing operating expense charge allocations might be improved?	See cover letter.